Supreme Court of the United States

OCTOBER TERM, 1943.

No. [redacted] 62

SPECTOR MOTOR SERVICE, INC., a corporation,
Petitioner,

vs.

CHARLES J. McLAUGHLIN, Tax Commissioner,
WALTER W. WALSH, Substituted Defendant,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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THE COURT PRESS, 130 Cedar Street, N. Y. C.

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CITATIONS

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

I.

Summary Statement of Matter Involved.

This is an action to enjoin the assessment of an excise tax by the defendant state tax commissioner upon the plaintiff, an exclusively interstate motor freight carrier, and for a declaratory judgment holding that the plaintiff was not liable to pay such excise tax. The defendant purported to act under the provisions of the Connecticut Corporation Business Tax Act of 1935 as amended, the pertinent parts of which are included in the Appendix to this petition.

In brief, the Connecticut Act provides that every corporation (with certain exceptions not here material)

"carrying on business in this state" shall pay annually "a tax or excise upon its franchise for the privilege of carrying on or doing business within the state" of 2 per cent of the defined net income received "from business transacted within the state during the income year." (Section 418c Cum. Supp. to General Statutes.) By Section 176f effective July 1, 1937, after a portion of the taxes involved in this case had accrued, the tax was made applicable not only to those corporations carrying on business in Connecticut but also to those "having the right to carry on business in this state."

As to those corporations whose trade or business is carried on "partly without the state," Section 420c provides that the tax shall be imposed on a base "which reasonably represents the proportion of the trade or business carried on within the state." Interest, dividends, royalties and net gains from the sale of assets are allocated on the basis of their source. The same section provides that income derived from business other than the manufacture, sale or use of tangible personal or real property shall be allocated within and without the state under regulations of the tax commissioner. However, when income is derived from the manufacture, sale or use of tangible personal of real property, the portion to be attributed to "business within the state" is determined by an allocation fraction which is the simple arithmetical mean of the three following fractions:

(1) $\frac{\text{Average monthly fair cash value of taxpayer's tangible property in Connecticut}}{\text{Total average monthly fair cash value of all taxpayer's tangible property}}$

(2) $\frac{\text{Wages paid to employees from Connecticut offices}}{\text{Total wages paid all employees of taxpayer}}$

(3) Gross receipts from transactions chiefly negotiated and executed in Connecticut

Taxpayer's total gross receipts (excluding income from interest and dividends or capital gains)

The plaintiff claimed and the trial court found that it was engaged in carrying freight by motor exclusively in interstate commerce chiefly from Chicago and St. Louis to the eastern seaboard and return and that it picked up and delivered freight in Connecticut but all in interstate commerce and that it had no power to engage in intrastate commerce and in fact at no time has so engaged. The plaintiff is a Missouri corporation with its executive offices in Chicago, Illinois. In Connecticut it maintains two rented depots for the transmission of freight in interstate commerce. It has 27 employees in Connecticut to service those depots but they are paid by draft on the plaintiff in Chicago, where all matters of rating and billing are handled. The plaintiff maintains a bank account in Bridgeport, Connecticut, where collections are deposited but no employee in Connecticut has authority to draw on that account. The plaintiff has no real estate in Connecticut and, apart from a few pick-up trucks, it owns in Connecticut personal property—mostly depot equipment—worth between $1500-$2000.

As the trial court found (Record, p. 115), the plaintiff, at the request of its landlord, on July 11, 1934, filed with the Secretary of the State of Connecticut a certificate of its incorporation in Missouri and also a certificate appointing the Secretary its attorney for service of process in Connecticut, pursuant to Section 3488, General Statutes of the State of Connecticut. That action, however, conferred no rights on the plaintiff because the plaintiff never was authorized, either by the Interstate

Commerce Commission or by the Public Utilities Commission of Connecticut, to conduct an intrastate business. Its only purpose and effect was to subject the plaintiff to personal liability if it should default in its rent.

The defendant state tax commissioner, purporting to act under the Corporation Business Tax Act, assessed the plaintiff for taxes claimed to be due for the years ending May 31, 1936, May 31, 1937, May 31, 1938, and for the period ending December 31, 1938, and for the years ending December 31, 1939, and December 31, 1940, aggregating the sum of $7,795.50.

The plaintiff thereupon brought this action in the United States District Court for the District of Connecticut where a judgment for the plaintiff was entered enjoining the defendant from enforcing payment of those assessments (47 Fed. Supp. 671). The trial court held that the statute, if applicable to the plaintiff, would be unconstitutional under the decisions of this court because in violation of the commerce clause. Hence it adopted the interpretation that the act was intended to apply only to those corporations a portion of whose business at least was intrastate, that is, within the State of Connecticut. It held, therefore, that the act did not apply to the plaintiff. From that judgment of the District Court the defendant tax commissioner appealed to the United States Circuit Court of Appeals for the Second Circuit where the judgment was reversed on the merits by a divided court (139 Fed. (2d) 809). This petition is to seek a review of that action of the Circuit Court of Appeals for the Second Circuit.

II.

Statement of Jurisdiction.

This action was begun in the United States District Court for the District of Connecticut to enjoin the collection of a tax alleged to have been imposed pursuant to the laws of the State of Connecticut. The trial court and the Circuit Court of Appeals concluded that there is no plain, speedy and efficient remedy afforded by the courts of Connecticut. Although the statute creating the tax permits an appeal from the assessment, it is the law of Connecticut that, by taking advantage of the appeal provisions of a statute, the appellant is precluded from attacking the constitutionality of that statute. *Lathrop* v. *Norwich*, 111 Conn. 616, 626, 151 Atl. 183 (1930). Likewise, injunctive relief against collection of taxes is not available in Connecticut. *Waterbury Savings Bank* v. *Lawler, Collector*, 46 Conn. 243 (1878); *Wilcox* v. *Madison*, 108 Conn. 223, 137 Atl. 742 (1927). The remedy by a suit for declaratory judgment in the state courts is clearly not adequate in view of the heavy penalties provided for non-payment of the tax (Sections 433e and 428e Cum. Supp. to General Statutes). In these circumstances, jurisdiction was vested in the District Court by virtue of 28 U. S. C. Sec. 41 (1), the parties being citizens of different states (Missouri and Connecticut), the amount in controversy being more than $3,000 and there being no "plain, speedy and efficient remedy" available in the courts of Connecticut. A complementary basis of jurisdiction in these circumstances is the Declaratory Judgment Act, 28 U. S. C. Sec. 400.

The Circuit Court of Appeals acquired jurisdiction by virtue of the defendant's appeal pursuant to the provisions of 28 U. S. C. Sec. 225.

This court has jurisdiction to grant this petition for certiorari and to hear this appeal by virtue of the provisions of 28 U. S. C. Sec. 347 (a) which authorizes this court, upon petition of a litigant, to cause a case to be certified to it from the Circuit Court of Appeals for final determination.

The judgment of the Circuit Court of Appeals sought to be reviewed was entered on January 20, 1944, and this petition is being filed in the office of the clerk of this court within three months of the entry of said judgment, as provided for in 28 U. S. C. Sec. 350.

III.

The Questions Presented.

There are five questions which the plaintiff desires to present to this court if certiorari is granted.

1. The first is that, properly construed, the taxing statute does not apply to the plaintiff because the statute is so phrased as to exclude from its scope foreign corporations which, like the plaintiff, are engaged exclusively in interstate commerce. The statute describes the levy as "a tax or excise upon its franchise for the privilege of carrying on or doing business within the state" and the allocation scheme attempts to tax only that business carried on "within the state."

2. The second is that, if the statute be construed to apply to the plaintiff, it is unconstitutional because it purports to levy a state excise tax on interstate commerce in violation of the commerce clause of the United States Constitution (Article I, Section 8).

3. The third is that, as construed by the defendant, the statute violates the due process clause of the United

States Constitution (Article XIV, Section 1) and of the Connecticut Constitution (Article II). In defining net taxable income, the statute (419e Cum. Supp. Gen. Statutes) does not allow rent to be deducted from gross income. The defendant has held that the cost of hiring trucks (which amounts to 60% of the plaintiff's operating expense) is "rent" and therefore not deductible. As a result, the assessment is not a tax on net income but approaches a tax on gross income in interstate commerce and therefore is unfair, discriminatory and violation of due process.

4. The fourth is that the assessments are void because made by the defendant, an officer of the executive department of the State of Connecticut, acting in a legislative capacity, in violation of Article Second of the Constitution of the State of Connecticut, which provides that "The powers of government shall be divided into three distinct departments and each of them confided to a separate magistry, to wit, those which are legislative, to one; those which are executive, to another; and those which are judicial, to another." The statute (Sec. 420e of the Supplement to the General Statutes), after providing for an allocation of such forms of income as interest, dividends, royalties and gains, provides that "The remainder of the net income of the taxpayer shall be allocated and apportioned as follows: (a) Such income when received from business other than the manufacture, sale or use of tangible personal or real property shall be specifically allocated within and without the state under rules and regulations of the tax commissioner."

The plaintiff's business is to sell its services. The use of personal property is merely incidental. As to such business, the defendant commissioner was directed by the statute to make an allocation without any standard

or principle to guide him and thus to exercise legislative power in violation of the Connecticut State Constitution.

5. The fifth is that the defendant commissioner made the allocation under an inapplicable section of the statute. He allocated the plaintiff's income under subsection (b) of Section 420e of the Cumulative Supplement to the General Statutes, which applies only to those corporations whose income is "derived from the manufacture, sale or use of tangible personal or real property". The plaintiff's business is, however, the sale of its services and the appropriate section governing allocation was subsection (a) of the same statute which applies to corporations whose income, as is the plaintiff's, is derived from business other than the sale or use of tangible property.

IV.

Reasons Relied on for the Allowance of the Writ.

This case raises the question whether a state may constitutionally levy an excise tax on interstate commerce conducted by a foreign corporation not domiciled within its borders and engaged exclusively in interstate commerce. The trial court held it could not. The majority opinion of the Circuit Court of Appeals, while agreeing that the decided cases of this court supported the trial court's position, stated that the trend toward overruling those decided cases impelled it to anticipate their overruling. See the language of the Circuit Court of Appeals referring to *Alpha Portland Cement Co. v. Massachusetts*, 268 U. S. 203:

> "When, however, a corporation is engaged within a state solely in interstate commerce, it must be con-

ceded frankly, and this is the basis of the thoughtful conclusion of the court below, that the Supreme Court to date has held it immune from net income taxation by that state. * * * If that were the whole story or if further our duty were limited to picking the closest unoverruled analogy in reported cases and following that blindly and mechanically, we should hold that these cases, and particularly the *Alpha Cement* case, had foreclosed all further discussion. But that is far from the whole story; the trends noted above have gone further in several specific cases fundamentally close to this and in divisions in the Court itself, which are certainly not without significance in forecasting the future course of the law. And our function cannot be limited to a mere blind adherence to precedent. We must determine with the best exercise of our mental powers of which we are capable that law which in all probability will be applied to these litigants or to others similarly situated."

The majority opinion of the Circuit Court of Appeals is therefore frankly and admittedly in conflict with the applicable decisions of this court. In addition to the *Alpha Cement* case already cited reference is had to the following:

Ozark Pipe Line Corp. v. *Monier*, 266 U. S. 555;
New York ex rel. v. *Knight*, 192 U. S. 21;
Cooney v. *Mountain States Telephone Co.*, 294 U. S. 384;
Puget Sound Stevedoring Co. v. *Tax Commission*, 302 U. S. 90;
Anglo-Chilean Nitrate Corp. v. *Alabama*, 288 U. S. 218.

We do not consider it necessary to labor the point because the full exposition of the problem in the majority and minority opinions of the Circuit Court of Appeals amply demonstrates what every one connected with this case conceded, namely, that the majority opinion of the Circuit Court of Appeals is in conflict with the decided cases of this court. For that reason we have not filed a brief in support of the petition but instead refer to the majority and minority opinions of the lower court as indicating that the problem is of a type and of such importance to merit a review by this court.

We submit also that the Circuit Court of Appeals decided an important question of local law contrary to the applicable decisions of the Supreme Court of Errors of Connecticut. In *State* v. *Stoddard*, 126 Conn. 623, 13 Atl. (2d) 753 (1940), the court held that an executive officer could not constitutionally be vested by statute with the power to make regulations unless the statute set up standards or principles to guide him in exercising his delegated power. That decision was approved and applied in *Connecticut Baptist Convention* v. *McCarthy*, 128 Conn. 701, 25 Atl. (2d) 656 (1942). The majority opinion of the Circuit Court of Appeals refused to follow these decisions of the Supreme Court of Errors, stating "we do not believe it intends to adopt a peculiar local rule." We submit that this constitutional question, having been twice decided in recent years in carefully considered opinions of the highest court of Connecticut, was a matter of established local law which the Circuit Court of Appeals was bound to follow. Because it failed to follow the local law, we submit we have an additional reason why this court should exercise its discretion and grant the writ.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of

this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit commanding that Court to certify and to send to this Court for its review and determination on a day certain to be therein named, a transcript of the record and proceedings herein; and that the decree of the Circuit Court of Appeals for the Second Circuit be reversed by this Honorable Court and your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just.

PETITIONER,

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APPENDIX.

Section 418c, 1935 Supplement to the General Statutes:

Sec. 418c. Imposition of tax. Every mutual savings bank, savings and loan association and building and loan association doing business in this state, and every other corporation or association carrying on business in this state which is required to report to the collector of internal revenue for the district in which such corporation or association has its principal place of business for the purpose of assessment, collection and payment of an income tax, except (1) insurance companies, (2) companies principally engaged in the transportation and communication business and subject to the gross earnings taxes under chapters 70, 71 and 72, (3) companies principally engaged in manufacturing, selling or distributing gas, electricity or water and subject to the gross earnings tax imposed under chapter 73 and (4) companies all of whose properties in this state are operated by companies subject to taxation under chapters 70, 71, 72 and 73, shall pay, annually, a tax or excise upon its franchise for the privilege of carrying on or doing business within the state, such tax to be measured by the entire net income as herein defined received by such corporation or association from business transacted within the state during the income year and to be assessed at the rate of two per cent; provided in no case shall the tax be less than the minimum tax as computed under section 421c and provided, when any company taxable under chapter 71 shall engage in any business in this state other than the carrying of passengers for hire in common carrier motor vehicles, such company shall be subject to a tax of two per cent measured by that portion of its total net income derived from such business but shall not be subject to the minimum tax computed under sec-

tion 421c. Notwithstanding any other provisions of this chapter, any mutual savings bank owning, at the end of the income year, real estate acquired for debt having an assessed valuation of ten per cent or more of its total assets shall, during the calendar years 1936 and 1937, be subject to the lesser of (1) the tax imposed by this chapter and (2) the tax imposed by chapter 68 as amended by section 355b of the 1933 supplement.

Section 419c, 1935 Supplement to the General Statutes:

Sec. 419c. Deductions from gross income. In arriving at net income as defined in section 417c whether or not the taxpayer is taxable under the federal corporation net income tax, there shall be deducted from gross income all items deductible under the federal corporation net income tax law effective and in force on the last day of the income year, except (1) federal taxes on income or profits, losses of prior years, interest received from federal, state and local government securities and specific exemptions, if any such deductions shall be allowed by the federal government and (2) interest and rent paid during the income year.

Section 420c, 1935 Supplement to the General Statutes:

Sec. 420c. Allocation of net income. If the trade or business of the taxpayer shall be carried on partly within and partly without the state, the business tax shall be imposed on a base which reasonably represents the proportion of the trade or business carried on within the state. The allocation of the base of the tax measured by net income shall be made on the following basis: (1) Interest, dividends, royalties and gains from sales of intangible assets, less related expenses, when received by a company having its principal place of business within the state, shall be allocated to the state and, when received by a company

having its principal place of business without the state, shall be allocated without the state; provided, when it can be clearly established that such income is received in connection with business within the state, such income shall be allocated to the state without regard to the location of the principal place of business of the taxpayer, and a similar rule shall apply to such income received in connection with business without the state; (2) gains from sales or rentals of tangible capital assets held, owned or used in connection with the trade or business of the taxpayer but not for sale or for rent in the regular course of business shall be allocated to the state if the property sold or rented be situated in the state prior to the sale or during the rental thereof, otherwise such gains shall be allocated outside the state; (3) net income of the above classes having been separately allocated and deducted as above provided, the remainder of the net income of the taxpayer shall be allocated and apportioned as follows: (a) Such income, when derived from business other than the manufacture, sale or use of tangible personal or real property, shall be specifically allocated within and without the state under rules and regulations of the tax commissioner; (b) when derived from the manufacture, sale or use of tangible personal or real property, the portion thereof attributable to business within the state shall be determined by means of an allocation fraction to be computed as the simple arithmetical mean of three fractions. The first of these fractions shall represent that part of the average monthly fair cash value of the total tangible property held and owned by the taxpayer during the income year which is held within the state, without deduction on account of any incumbrance thereon but excluding any property the income of which is separately allocated under the foregoing provisions of this chapter. The second frac-

tion shall represent the part of the total wages, salaries and other compensation to employees paid by the taxpayer during the income year from offices, agencies or places of business within the state, provided all such payments shall be assigned to the office, agency or place of business of the taxpayer at which the employee chiefly works or from which he is sent out or with which he is chiefly connected. The third fraction shall represent the part of the taxpayer's gross receipts from sales or other sources during the income year, excluding any income which is specifically allocated under subdivisions (1) and (2) of this section, which is assignable to offices, agencies or places of business within the state, provided such receipts shall be assigned to that office, agency or place of business at or from which the transactions giving rise thereto are chiefly negotiated and executed.